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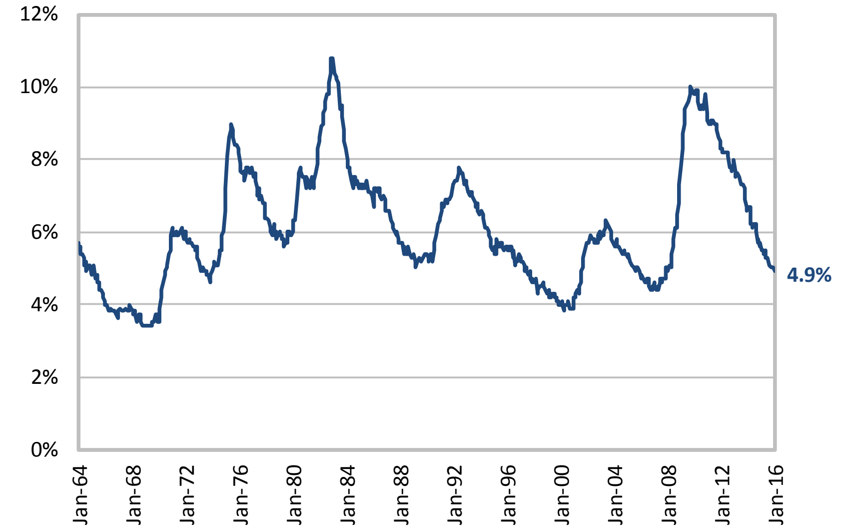
Monthly Economic & Capital Market Update

January 2016

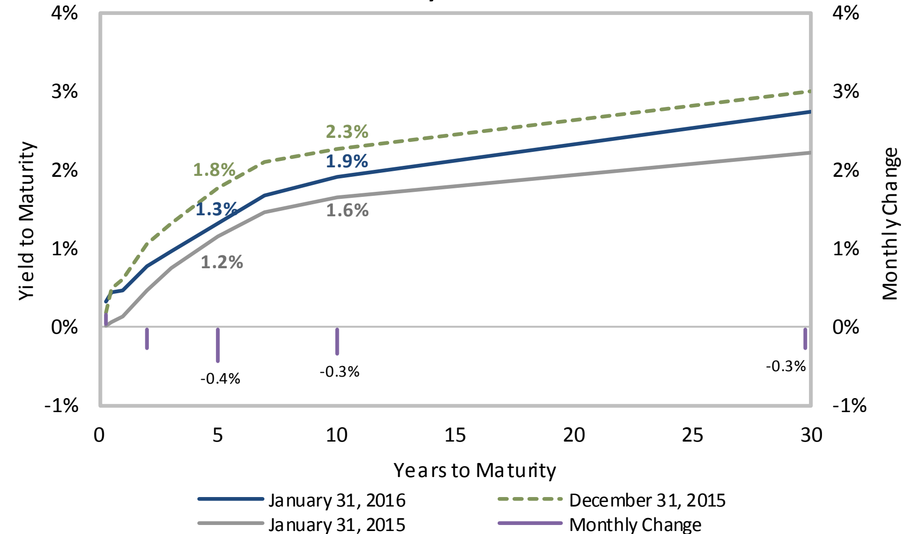
Economy

- January proved to be a turbulent start for 2016. Following the anticipated Federal Reserve interest rate increase in December, the Fed did not raise its key interest rate at its January meeting. Chair Janet Yellen also acknowledged the slower-than-expected pace of economic growth at the end of 2015, which could be a sign the committee will slow the pace of interest rate increases going forward. Instability within the Chinese equity market, volatile oil prices, and uncertainty around central bank policy drove the markets' negative returns.
- The January employment report showed mixed results for the US labor market. Employers added 151,000 jobs during the month, falling short of market expectations. However, the unemployment rate dropped to its lowest level since February 2008, at 4.9%. In addition to the mixed January report, revisions for November and December were net negative a combined 2,000 jobs, while monthly job gains over the past three months have averaged 231,000. Historically, 200,000 new jobs per month has been consistent with strong labor market expansion.
- Oil was once again in the headlines in January as prices tumbled below $30 per barrel for the first time in 12 years. Prices rebounded somewhat to end the month at $32 per barrel, but were still 9.2% lower month over month. Consumers continue to benefit from the decline in oil prices, as gasoline prices have also fallen. Throughout January, the average gas price per gallon in the US remained below $2.00, down dramatically from $3.67 in June 2014.
- Real GDP slowed to a 0.7% annualized rate during the fourth quarter, according to the Bureau of Economic Analysis**.** This rate trails previous GDP growth rates (annualized) from the second and third quarters of 2015, showing 3.9% and 2.0%, respectively. Overall GDP growth for 2015 was 2.4%.
- The service sector continues to drive US growth, while manufacturing has contracted in recent months. The ISM non-manufacturing purchasing managers' index (PMI) for January showed the service sector expanded for the 72nd consecutive month, while the manufacturing index saw a 4th straight month of contraction.



Yield Curve

- The spread between 2-year and 30-year Treasuries held constant at 200 bps in January. Over the past 30 years this spread has averaged 165 bps.



Growth Assets

January 31, 2016

Public Equities

- Global markets stumbled into 2016 with indices finishing the month of January broadly in the red. The S&P 500 fell 5.0% over the course of the month with domestic small cap equities experiencing an even larger decline, as the Russell 2000 fell 8.8%. In international markets, the MSCI EAFE Index lost 7.2% for the month and emerging markets posted a decline of 6.5%.
- All MLP subsectors declined in January. Midstream energy continues to face negative sentiment as production declines from North American oil and gas producers loom; commodity prices remain low and exploration and production capital expenditures continue to be reduced. General partner MLPs (-22%), gathering and processing MLPs (-21%), and crude oil pipeline MLPs (-15%) all declined more than the Alerian MLP Index. Natural gas pipeline MLPs (-8%) and refined products pipeline MLPs (-9%) outperformed the index but still experienced price declines.

Public Debt

- High yield bonds slipped to start 2016, declining 1.6% in January. The biggest laggards were commodity-sensitive bonds, with the energy sector down -8.4%.
- Local currency EM debt gained modestly, returning 0.3% in January. Commodity-sensitive currencies (Columbia, Russia, Mexico, and South Africa) detracted.

Private Equity

- Purchase price multiples, as measured by S&P Leveraged Commentary and Data (LCD), remain at record high levels; the easy availability of credit and record levels of dry powder were the main drivers. Market participants noted a widening bid/ask spread as lenders began to tighten, and public market volatility combined with peak earnings has given some buyers pause. However, the aggregate deal value in 2015 rose 16% YoY and the average deal size reached its highest level since 2007.

Private Debt

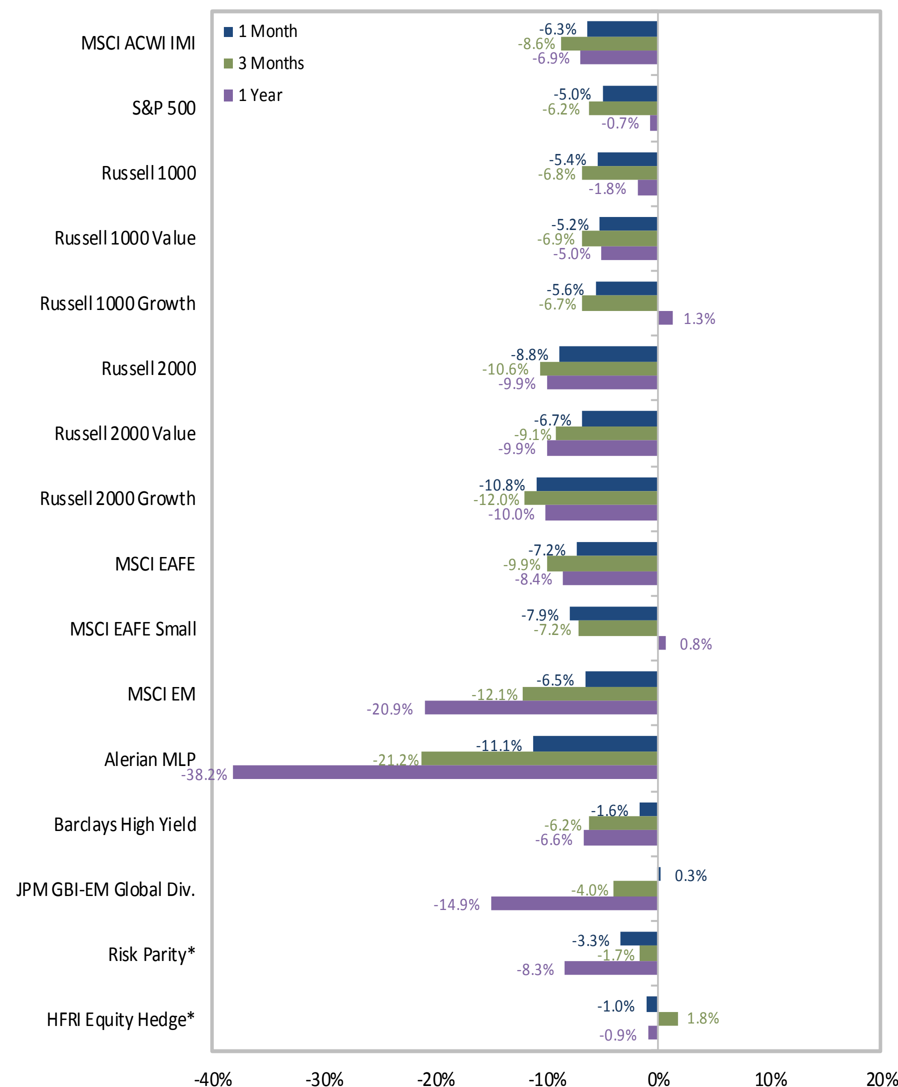
- Following five years of expanding leverage multiples, 2015 saw a slight cooling in the sponsored loan market. Increased attention to regulatory lending guidelines, as well as some natural trepidation with overall credit statistics, led to the slowdown. For deals that are getting done, market participants noted a reduction in unitranche lending in favor of more traditional debt structures.

Risk Parity

- Risk parity strategies detracted in December, with losses in equities, commodities, and fixed income.

Growth Hedge Funds

- Growth hedge funds detracted in December. Equity long/short strategies were down in aggregate given the negative equity market performance, and distressed debt also declined. Merger arbitrage strategies contributed small gains.



* Data was not available at time of publication – returns are previous month's.
Note: Risk Parity returns are based on an internally comprised benchmark.
All returns are USD.

Public Debt

- Risk-off sentiment helped to drag rates lower during the start of the year, leading to a second straight month of US Treasury outperformance. Treasuries returned 2.1% in January on the back of falling yields. Weakening global growth, continued pressure on oil, the introduction of negative rates in Japan, and doubts over the ability of the Federal Reserve to hike rates further combined to bring the 10-Year Treasury yield down 35 bps.
- Investment grade credit spreads were higher by 26 bps but still managed to return 0.5% with the larger drop in rates. Heavy issuance of $120 billion, including the AB InBev $46 billion issue, added further pressure on weakening spreads. At 181 bps, spreads are at levels not seen since mid-2012 and 55 bps wider than the 25-year median level. Metals & mining and energy were again at the center of the storm, each down more than 4% over the month.
- Securitized sectors continue to be a relative safe haven with MBS, ABS, and CMBS all posting positive returns for the month. CMBS witnessed a second straight month of widening spreads but falling rates overwhelmed any negative impact from spread movement.
- International bonds gained 0.5% in January as declining yields in the eurozone and Japan outweighed slight USD strength versus the euro and yen.

Private Debt

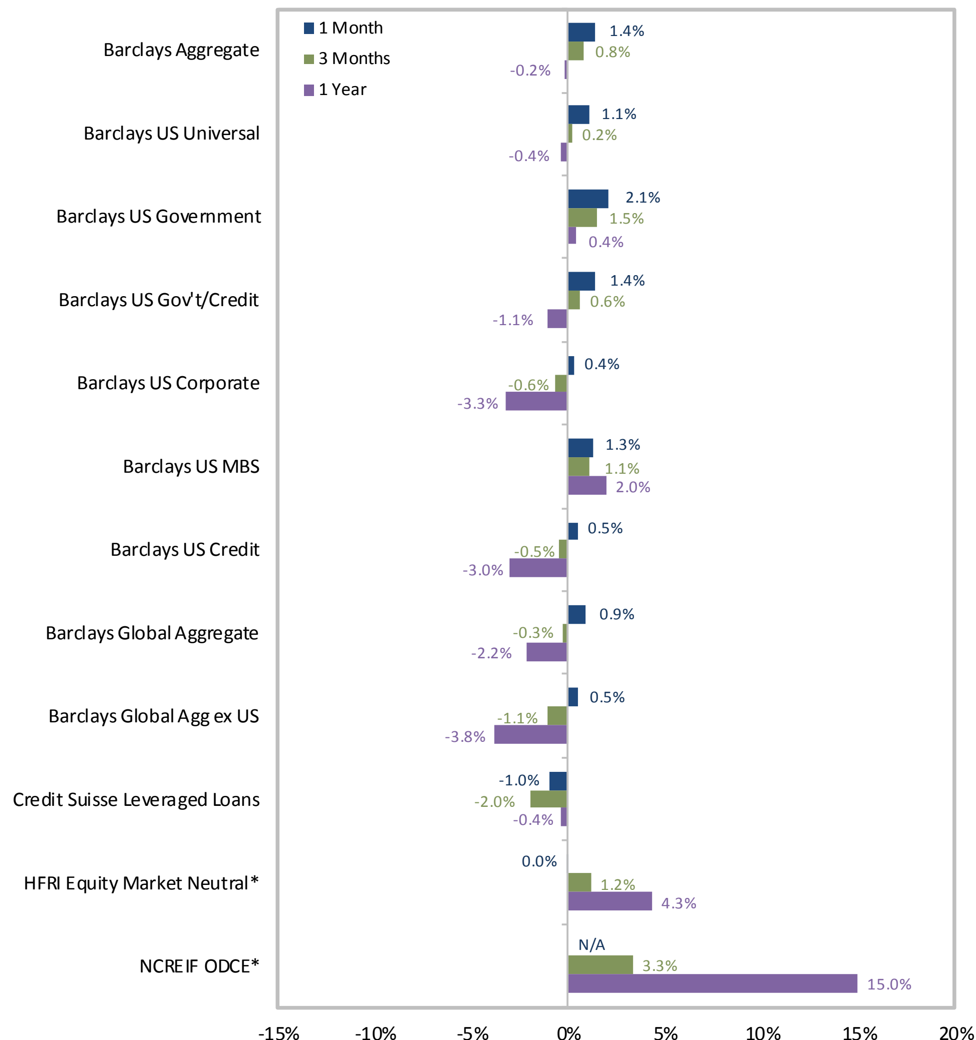
- Bank loans fell for the sixth straight month, as average prices fell to $90, the lowest level since August 2010. Continued outflows and a -10% month for energy issues were drivers of the negative performance. Current discount margins imply a 5.7% default rate.

Relative Value Hedge Funds

- Income hedge funds posted disparate performance in December. Equity market neutral strategies were up in aggregate, while relative value volatility strategies were the strongest contributors; credit strategies detracted.

Core Real Estate

- Core real estate continued to perform well with a total return of 3.3% for the fourth quarter of 2015, as measured by the NCREIF ODCE Index. As a result, the 2015 calendar year return for the Index was 15.0%, the strongest year since the financial crisis for real estate. Supportive supply and demand fundamentals and continued economic growth have fueled strong returns in recent years.



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Diversification Assets

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Inflation

- TIPS returned 1.5% in January, underperforming nominal Treasuries as breakeven inflation expectations narrowed along the curve. As of the end of January, the breakeven inflation rate for the 10-year TIPS was 1.4%, down 15 bps for the month.

Deflation

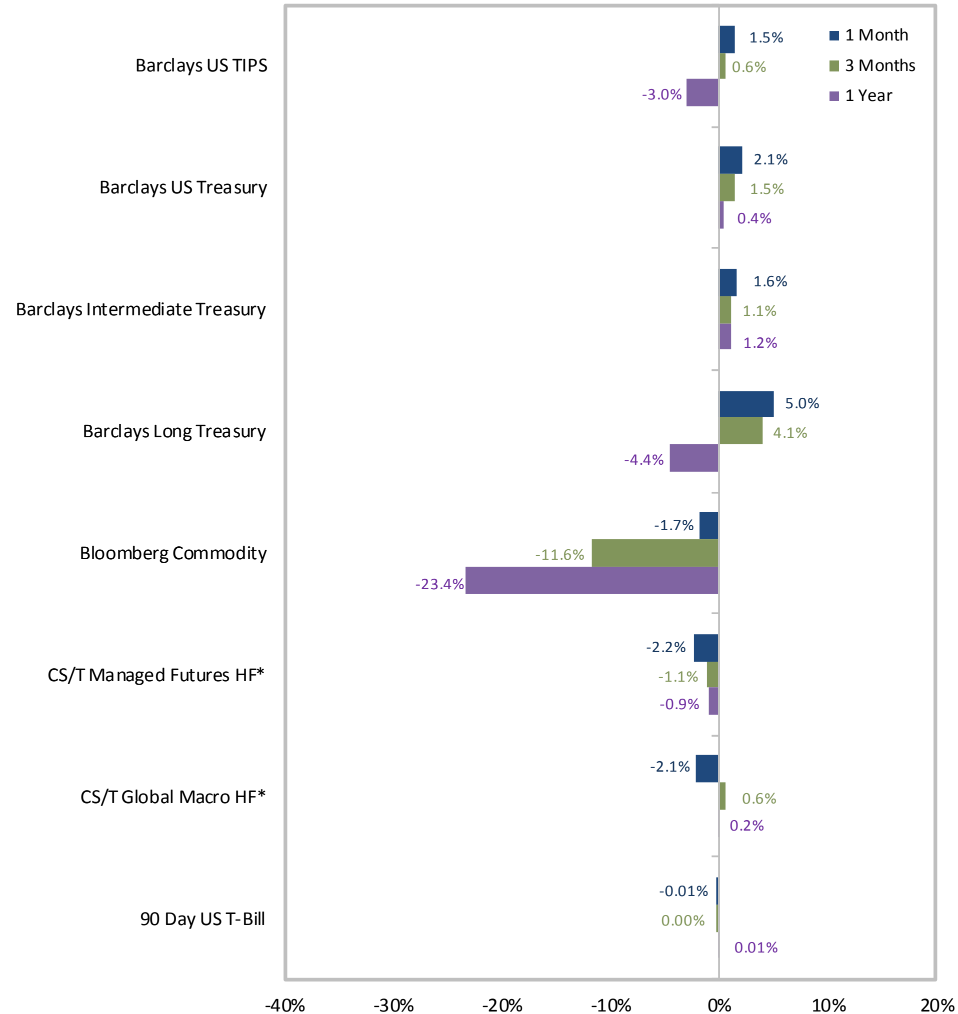
- Long Treasuries provided the downside protection investors have come to expect with yields falling 27 bps for the 30-year Treasury, helping push the Barclays Long Treasury return to 5.0% for the month.
- Cash continues to offer no return, with 90-day T-Bills adding just 1 basis point over the past year.

Commodities

- In agriculture, both grains (+3%) and livestock (+1%) sectors advanced while soft agricultural commodities declined (-9%) on expectations of growing global production in key planting regions. Energy commodities declined broadly as WTI crude (-12%) and gasoline (-13%) experienced continued inventory builds. Precious metals, both gold and silver, advanced during the month along with several industrial commodities. Copper continued to fall as lower energy prices have reduced operating costs, deferring anticipated production cuts.

Tactical Trading

- Diversification hedge funds declined in December, with discretionary global macro and CTAs both detracting.



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